

geographic areas. The only condition that would justify material change to the existing basket structure would be the emergence of effective competition on a broad geographic basis. At this time, the Committee hopes that such competition emerges, but does not believe that it now exists. Moreover, the LEC Pricing Flexibility NPRM does not assert that such competition now exists. The NPRM, however, seems to assume that such competition will occur, and perhaps soon, but provides no factual information to support such a perception. The Commission should key its price cap rules to the development of actual competition. Excessive and premature relaxation of the price cap rules will hurt end users and endanger the development of competition in LEC markets.

Ad Hoc will maintain an open mind on the issue of whether cross-elasticities among services might warrant service category consolidation. If the proponents of alternative service groupings, persuasively establish high cross-elasticities of demand for the services in the proposed service categories, and demonstrate that the proposed service categories will not adversely affect the development of competition and end users, the Committee will support a new category structure.

II. THE ELIMINATION OF BARRIERS TO ENTRY IS NOT SUFFICIENT TO WARRANT ADDITIONAL PRICING FLEXIBILITY.

The Commission seeks comment on whether the existence of barriers to competitive entry is a legitimate measure of competitive condition within relevant markets. The Commission suggests that

additional price cap flexibility for LEC access services be conditioned upon the lowering and/or elimination of entry barriers.³⁶

If elimination of barriers to entry is to be a prerequisite as a criteria for relaxed regulation, the Commission seeks comment on what items should be included in what it terms a “competitive checklist,”³⁷ and whether the elimination of all barriers to entry would in itself be sufficient to move prices toward cost in the interstate access market. Finally, the Commission invites comments on the use of the Rochester model for future purposes.

The “competitive checklist” proposed by the Commission includes the following eight items:

- a. competing providers of local switched telephone service have been authorized and have become operational;
- b. local loops and switches have been unbundled, *i.e.*, a LEC's competitors may obtain access to the local loop directly, without purchasing local switching or other services;
- c. intrastate expanded interconnection is available through tariff or contract (physical or virtual collocation);
- d. service provider number portability is available, *i.e.*, end users are able to switch local service providers and retain their current telephone number;
- e. compensation arrangements have been established for the LEC and its competitors to complete telephone calls originated on the other carrier's networks;

³⁶ NPRM at ¶ 106.

³⁷ NPRM at ¶ 110.

- f. competitors have access to directory assistance, 911, and other databases;
- g. intraLATA toll dialing parity is implemented, *i.e.*, consumers are able to place calls dialing the same number of digits when using any local service provider; and
- h. competitors have implemented or announced plans to collocate, or otherwise deploy facilities, and serve customers in wire centers (or other geographic areas) that account for a significant portion of the incumbent LEC's business lines or interstate access revenues.³⁸

While the Committee certainly supports elimination of barriers to market entry, it cannot support any proposal that would link the granting of pricing flexibility to the elimination of such barriers. The removal of some or all of the entry barriers within the Commission's control is not the same as the *existence* of a level of competition sufficient to constrain LEC anti-competitive and monopoly pricing practices -- in fact elimination of such barriers is not even a guarantee that competition will in fact develop in all geographic or product market segments in the long term. Elimination of the entry barriers delineated in the proposed "competitive checklist" is a necessary precursor to the development of full

³⁸ NPRM at ¶ 108 (footnote omitted). If items (a) through (g) on the Commission's checklist do in fact encompass all of the major barriers that need to be eliminated, the development of competition as measured by item (h) should in and of itself be an indication that these barriers have been appropriately eliminated. Conversely, if competition as measured by item (h) does not develop, that can be taken as an indication that either the barriers have not been appropriately eliminated, or that items (a) through (g) do not cover all elements required for the development of competition. Either way, item (h) alone can be viewed as negating the need for items (a) through (g) in the evaluation of the appropriateness of additional pricing flexibility.

and effective competition, but the Commission must rely upon the demonstrable existence of some level of competition, not the elimination of entry barriers, as the guideline for increasing the level of pricing flexibility available to the LECs.

The use of pricing flexibility as a "carrot" to incent the LECs to do that which they should already be doing is inappropriate. Regulators have both the authority and the responsibility to ensure appropriate LEC behavior - whether that behavior relates to the setting of just and reasonable rates or the unbundling of loops and ports. In the instant case the pricing flexibility "carrot" that the Commission is holding out is doubly troubling -- wrong because a "carrot" is simply not necessary or appropriate in the instant case, and wrong because the "carrot" has the potential of undermining the Commission's desired outcome.

The pricing, terms and conditions under which items on the "competitive checklist" are provided is so important that the checklist should not be considered satisfied if rates, terms and conditions are not found reasonable. If the LECs offer competitors all of the elements delineated in items (b) through (g), but does so at uneconomic prices, the fact that such arrangements are available will mean very little. Consider a situation in which an LEC offers unbundled loops and switch ports, but offers them at prices that are excessive relative to the prices at which it offers retail services to end users, as in the following example. Earlier this

year NYNEX-Massachusetts submitted a proposal to the Mass DPU to charge \$21.00 per month for an unbundled residence loop (without a port or any local usage), a rate that is some 25 percent *higher* than the price NYNEX charges its retail residential customers for a bundled dial tone line (loop and port) with flat-rate (unlimited) local calling.³⁹ Should this tariff go into effect as proposed, NYNEX will have met the item (b) test in Massachusetts, but the opportunity for competitors to actually enter the market in Massachusetts and compete for residential customers through purchase of unbundled loops will still be virtually non-existent. Similar examples could be made relative to items (c) through (g). Therefore, if the Commission chooses to go forward with the use of its "competitive checklist", the Committee urges it to include in its rules language that considers whether the prices, terms and conditions at which the checklisted items are offered are set at appropriate levels.⁴⁰

The Commission questions whether the elimination of barriers to entry is enough to cause interstate prices to move closer to cost, and also questions whether the present "Rochester" experience offers any insight into other useful models. As should be clear at this

³⁹ *Investigation by the Department on its Own Motion into IntraLATA and Local Exchange Competition in Massachusetts*, Massachusetts DPU 94-185, Testimony of Paula Brown (NYNEX) (May 19, 1995).

⁴⁰ The Commission's own experience with the exorbitant expanded interconnection prices originally proposed by the LECs in response to the FCC's Docket 91-141 requirements to allow interstate central office interconnection should not be forgotten in reference to this discussion.

point, the Committee does not believe that the elimination of barriers to entry is in and of itself enough to constrain interstate prices. The Committee believes that the "Rochester" experiment might in fact offer some useful insights - but not into how local companies might best be structured as the Commission initially queried.⁴¹ A quick glance at the experience to date with facilities-based competition in Rochester demonstrates that the mere removal of barriers will not necessarily result in vibrant competition overnight. At year end 1994 Rochester Telephone reported 340,189 residence access lines and 155,867 business access lines - close to half a million exchange access lines total. A New York Times article published only a month and a half ago indicates that close to a year into the "Open Market Plan" experiment in Rochester, Time Warner, the largest of the facilities-based carriers, has so far, *wired only three apartment buildings and is serving a total of 45 to 50 customers.*⁴²

Ad Hoc urges the Commission not to implement separate measures of competition for use in justifying additional pricing flexibility and for granting streamlined regulation. The level of competition

⁴¹ Note that Rochester Telephone did not, in the end, set up a separate subsidiary for wholesale activities. The restructuring that was ultimately approved by the New York Public Service Commission allowed Rochester Telephone Corporation to be split into two entities, one that provides both retail and wholesale services (Rochester Telephone Corporation) and a second lightly-regulated, non-facilities-based resale retail entity (Frontier Communications of Rochester, Inc.).

⁴² See *The Big Boys Come Calling: Rochester Is Courted by AT&T and Time Warner*, The New York Times (Oct. 23, 1995).

appropriate for either may differ in degree, but certainly not in kind. The presence of "actual" competition for a given service (whether a new or existing service) not the hope that it will develop, is what the Commission must use as it makes decisions relative to pricing flexibility.

A. The Commission Should Not Define "Markets" (Both Product And Geographic) Too Broadly.

The Commission has requested comment on whether the existing price cap baskets are appropriate for use in defining the relevant product markets for evaluating LEC market power relative to specific access services.⁴³ Additionally, the Commission seeks comment on the appropriate geographic unit for evaluating the existence of competition, and whether a finding of competitive conditions in a geographic unit smaller than an entire study area should result in a change in regulatory treatment for the specified geographic unit, or for the study area as a whole.⁴⁴

In defining both geographic and product markets, the Commission must recognize that LEC services are provided over facilities that provide both intra- and interstate services, and that support multiple services across wide geographic areas. Recognizing the joint nature of

⁴³ NPRM at ¶ 118.

⁴⁴ NPRM at ¶ 125.

the facilities is essential to properly defining markets for pricing flexibility (or streamlined regulation) purposes. Although an LEC may in fact face actual competition for a particular service in a particular geographic area, that fact alone may not be enough warrant pricing flexibility if the LEC provides the service over facilities that are commonly used to provide other services that do not face competition. Utilization of common plants to provide a variety of services is, of course, the rule, rather than the exception today, and will be the case in the future as well. LECs would have both the incentive and the ability to recover revenues lost from competitive services from non-competitive services. Price cap regulation does not eliminate this problem.

Regardless of the interstate service baskets and geographic boundaries the Commission chooses, it should apply its tests of competition to the combined interstate and intrastate offerings of the LECs. Although the Commission regulatory authority is limited to LECs' interstate operations, the Commission should ignore jurisdictional boundaries in determining appropriate markets for economic regulation.⁴⁵

B. The Existing Price Caps Categories Are A Reasonable Start For Product Definition.

⁴⁵ In some cases it can be expected that competition in the interstate and intrastate portions of product market will occur at the same time and level - private lines (special access) being a prime example. In other cases this is less likely to be true.

The Commission proposes to use the existing price cap service categories as a foundation for assessing the market power of LECs.⁴⁶ Ad Hoc agrees that it would be reasonable to use the price caps categories as a starting point in the definition of product markets, provided that the Commission accounts for the weaknesses of this approach. Certainly some product markets (*i.e.*, transport) will become competitive before others (*i.e.*, local switching). The Commission should not unduly limit pricing flexibility in competitive access service product markets until such time as all access service markets are competitive. While the baskets and service categories used in the price caps plan are useful for defining product markets, the Commission must be careful to note the inter-relationships among categories and among non-FCC regulated services.

Primary among the Committee's concerns is the impact the Residual Interconnection Charge ("RIC") (which lives in a service category of its own that will *never* become competitive because it is not even a service) has upon the development of competition. Until the RIC is completely phased-out, and/or an LEC proposes to discontinue charging the RIC in a geographic area for which transport or switching charges have been deemed "competitive," the Commission should not grant a LEC switched access pricing flexibility. The RIC impacts the trunking basket

⁴⁶ NPRM at ¶ 118.

because it is essentially a "make whole" rate element that guarantees that the LECs continue to receive up to 80% of the revenues associated with transport services even if they set the price of a particular transport facility at \$0 - the potential abuses of pricing flexibility in such a scenario are substantial. The RIC also reflects the fundamental lack of competition in the switching market. In a "competitive" market, a single service provider that had excess embedded costs for one service would not attempt to recover those costs through a separate charge appended onto a different competitive service that recovers costs that its competitors do not face. The very fact the RIC exists and that the LECs argued strenuously for the RIC is evidence that the LEC product markets for switching and transport are not yet competitive.

C. The Present "Density Zones" Are Not Relevant Geographic Markets.

The Commission questions whether it should use the density zones developed for the provision of expanded interconnection service as the geographic market for access services.⁴⁷ These density zones are not appropriate geographic market boundaries. Ad Hoc suggests that the Commission use either all central offices subtended by a single tandem, or the LATA as the appropriate geographic serving unit.⁴⁸ Either measure is appropriate, provided that all customers within the geographic area have competitive alternatives. If such is not the case (*i.e.*, if customers within certain areas within the LATA or subtending a particular tandem do not have competitive alternatives), then it still may be appropriate to grant pricing flexibility, with the caveat the price changes for services or rate elements be made uniformly across the geographic serving area.

III. **ALTHOUGH THE PROPOSED GUIDELINES FOR EVALUATING WHEN STREAMLINED REGULATION IS APPROPRIATE ARE REASONABLE, DISCUSSION OF SUCH GUIDELINES IS PREMATURE.**

The Commission requests comments on a proposal to "rely more heavily on market forces to achieve [its] public policy goals." and

⁴⁷ NPRM at ¶ 120.

⁴⁸ Wire centers alone are much too small a geographic unit.

appropriate methods of measuring the existence of such market forces.⁴⁹

The Committee anxiously awaits the day when the Commission and the LECs' customers can rely on market forces to achieve the Commission's public policy goals. That day, however, may be long in the future. Ad Hoc believes that focusing on measures to determine when "streamlined" regulation is warranted, in advance of the evidence of any measurable level of competition for the vast majority of LEC interstate access services, is at least premature. The time of both the Commission and industry participants would be much better spent working towards creating conditions that would facilitate the development of "market forces" on which the Commission and LEC customers could rely.

The Commission questions whether the basic framework used to streamline regulation of AT&T's services would be appropriate for use in relaxing the regulation of the LECs.⁵⁰ The standards embedded in that framework are appropriate economic measures for assessing competition within relevant markets and, thus, for determining whether to relax regulatory oversight. However, as stated above, the LEC access markets may be years away from being effectively competitive and thus warranting streamlined regulation. There is substantial danger that if the

⁴⁹ *Order on Motion for Extension of Time, Price Cap Performance Review for Local Exchange Carriers*, CC Docket No. 94-1, DA 95-2340 (Nov. 13, 1995).

⁵⁰ NPRM at ¶ 128.

Commission establishes today a test for streamlined regulation that would not warrant streamlining regulation of LEC services for years to come, the LECs unrelenting lobbying will eventually create a strong temptation to weaken the test.

If, however, the Commission decides to set streamlined regulation standards in this docket, it should use the following criteria to measure the competitiveness of LEC markets.

- Market share: The most important of the criteria. Data collected by the Commission in conjunction with TRS funding provides ample market share information for the present time.⁵¹

In the future (as the level of competition in the service categories becomes notable) the Commission may consider instituting additional filing requirements (that should not be burdensome for carriers to fulfill) that detail revenues at a more granular level. For the foreseeable future, however, the TRS worksheets are sufficient.

- Demand responsiveness.

⁵¹ The Telecommunications Relay Service ("TRS") Fund Worksheets that have been filed since 1993 enable the Commission to compare separately the revenues associated with several categories of relevant services such as local exchange service and access revenues for the incumbent local exchange carriers and for other providers. As of 1993, CAPs' revenues for intrastate and interstate access were approximately \$96-million and LECs' revenues for intrastate and interstate access were \$30.6-billion, more than 300 times as much as those of the CAPs. This reports show that as of 1993, incumbent LECs' revenues for local exchange service were approximately \$40-billion, and, as with the access services market, there was not remotely any competition.

- Supply responsiveness.

The pricing of services under price cap regulation should not be afforded any particular weight unless and until the LECs face substantial competition in all segments of their markets.

CONCLUSION

In view of the foregoing, Ad Hoc urges the Commission not to adopt the First Gradation proposals, except for the proposals that would (1) allow the LECs to reduce rates for certain interstate access services and (2) severely limit the LECs ability to subsequently increase the rates for services in the same categories and baskets and to cross-subsidize the rate reductions. The Commission also should not delude itself into thinking that implementation of a competitive checklist would be sufficient to transform the LEC markets into effectively competitive markets.


The Commission should relax regulation of LEC interstate services when LEC markets are effectively competitive. The Commission should consider market share and supply and demand elasticities in evaluating the

competitiveness of LEC markets. Until reliable data demonstrate that LEC markets are effectively competitive, the Commission should not consider streamlining its regulation of LEC interstate services.

Respectfully submitted:

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December 11, 1995

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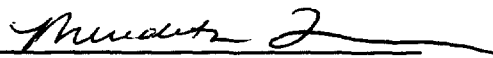
CERTIFICATE OF SERVICE

I, Meredith Forman, hereby certify that true and correct copies of the foregoing Comments of the Ad Hoc Telecommunications Users Committee were served this 11th day of December, 1995 via hand delivery upon the following parties:

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